

REQUEST FOR COUNCIL ACTION

MEETING

DATE: 10/6/03

AGENDA SECTION: Reports & Recommendations	ORIGINATING DEPT: City Administration	ITEM NO. F-1
DESCRIPTION Consideration of ALLCO Leaseback proposal		PREPARED BY: T. Spaeth

At the September 22, 2003 COW meeting, the Council discussed and came to consensus that the City should proceed with the Letter of Agreement to commence the next phase of the proposal with ALLCO Finance Corporation. ALLCO has been working with the League of Minnesota Cities to develop a long term lease / leaseback proposal of a defined set of assets such as wastewater facilities that are owned by the municipality.

Upon acceptance of a Letter of Agreement, ALLCO will begin the process of arranging the transaction, with acceptable terms to the City. In its role as arranger of the Transaction, ALLCO shall, at its sole expense:

1. Engage expert appraisers to establish a fair market value of the Assets.
2. Engage engineering experts as necessary to perform due diligence tasks and support
3. Pay the cost of nationally recognized bond counsel.
4. Reimburse the City for the reasonable costs with respect to the Transaction, of the City's outside attorney.
5. Assist the City in identifying the potential benefits of the Transaction.
6. Assist the City in structuring the Transaction.
7. Prepare offering materials, and market the Transaction to the investment community.
8. Solicit interest from equity investors to participate in the Transaction.
9. Assist in the preparation of all Transaction documents.
10. Assist in the closing and funding of the Transaction.

Upon execution of a Letter of Agreement, ALLCO will make a good faith effort to have the appraisal process completed within 6 months, and then proceed to market the Transaction to potential investors. In consideration of the services cited above, the City will grant ALLCO the exclusive right to arrange a Transaction for the City for a period of 24 consecutive months commencing on the date of acceptance of this Letter of Agreement.

It is the staff's recommendation that the ALLCO exclusive right term be limited to a period of 18 consecutive months, rather than the 24 months as contained in the letter of Agreement, and that the City also reserves the right to discuss with ALLC whether it is in the City's best interest to aggregated with other communities or listed as a separate offering.

Execution of a Letter of Agreement with ALLCO does not commit the City to approving a Transaction. The City's ultimate decision as to whether to enter into a Transaction arranged by ALLCO is specifically contingent upon: 1) ALLCO delivering to the City a Transaction with terms and conditions deemed appropriate and acceptable to the City; 2) the negotiation of documentation acceptable to the City; and 3) the receipt of all necessary City approvals.

Council Action Requested:

Authorize Mayor and City Clerk to execute the Letter of Agreement with ALLCO on behalf of the City.

COUNCIL ACTION: Motion by: _____ Second by: _____ to:

LEASE OF CITY WATER AND WASTEWATER SYSTEMS

The Rochester City Council is considering action on an initial step on a proposal under which it would lease the City's water and wastewater systems to large investors who wish to obtain the depreciation tax credits. The City would lease back those systems and it would continue to own and operate the systems. There would be no impact on the daily operations for the customers. The only change relates to the sale of the depreciation tax credits, which city utilities do not benefit from. This proposal is not arising as a result of the current operating budget reductions of the City. The Minnesota League of Cities endorsed and brought this proposal to a group of the largest cities in Minnesota this summer unrelated to operating budget concerns. Many of those cities are currently considering this proposal.

The investors would pay for an appraisal of the City water and wastewater systems. They would pay the City 100% of the appraised value and the City would deposit approximately 97% of that amount as its cost to lease back and re-acquire the full rights to the utilities after 30 years. The remaining 3% is the profit to the City, its citizens, and ratepayers. We anticipate that the appraised value may be between \$200 million to \$400 million, netting a profit at 3% of \$6 million to \$12 million. That profit would help reduce future water and wastewater rate increases for new utility improvements that need to be made over the next 10 years.

The City officials had many questions about this proposal. The answers have allayed our initial skepticism. Lease proposals for depreciation tax credits have been done many times for the major transit systems in the larger US cities and in Europe. In addition, the largest cities in South Dakota are currently out for bids for a lease of their water and wastewater systems. These are allowed transactions under IRS regulations. The investors assume all the risk for any changes in federal tax law. We also requested that the League of Cities review this proposal with the State Finance Commissioner and other leaders of the Legislature. To date no concerns have been expressed.

The City may take an initial step to authorize the appraisal and will be doing more study on the proposal. A final decision will not be made until more information is available some months from now.



Letter of Agreement

September 16, 2003

Mr. Gary Neumann
Assistant City Administrator
City of Rochester
201 4th Street SE
Rochester, Minnesota 55904

Re: Long-term lease/leaseback proposal

Dear Mr. Neumann:

Over the past several months, Allco Finance Corporation (hereinafter "Allco") has been working with the League of Minnesota Cities (hereinafter "LMC") to develop a **'long-term lease/leaseback financing program'** (defined as the lease/leaseback of a defined set of Assets in a single closing or multiple closings, hereinafter "Transaction") for Minnesota cities. We have specifically focused on wastewater and drinking water system assets (hereinafter "Assets") owned and operated by Minnesota municipalities.

In our investigation, we have retained the counsel of Dorsey & Whitney LLP to assist in the investigation of the legal, regulatory and tax implications of the Transaction from a city perspective. In summary, Dorsey & Whitney has concluded, that if properly structured, including certain approvals at the State and Federal level, a Transaction as contemplated could be executed.

Allco is now prepared to commence the next phase of the process. Upon acceptance of this Letter of Agreement, Allco will begin the process of arranging the Transaction, with the goal of delivering a Transaction with acceptable terms and conditions to the city.

The city's ultimate decision as to whether to enter into a Transaction arranged by Allco is specifically contingent upon: 1) Allco delivering to the city a Transaction with terms and conditions deemed appropriate and acceptable to the city; 2) the negotiation of documentation acceptable to the city; and 3) the receipt of all necessary city approvals.

In its role as arranger of the Transaction, Allco shall, at its sole expense:

1. Engage expert appraisers to establish a fair market valuation of the Assets.
2. Engage engineering experts as necessary to perform due diligence tasks and



support.

3. Pay the cost of "nationally recognized bond counsel " (hereinafter "Joint City Bond Counsel"), retained by participating cities to lead negotiations on behalf of participating cities. The Joint City Bond Counsel will represent the participating cities and report to the cities' Utility Directors, Finance Officers, and City Attorneys. The role of the Joint City Bond Counsel will include the responsibility to review and comment on, and assist in the negotiation of, the Transaction documentation; provide general guidance to the cities as to the impact of the Transaction on outstanding tax-exempt bonds and flexibility to issue new bonds, and advise as to compliance with Minnesota law authorizing the execution and delivery of the Transaction documents.

It is acknowledged that Allco agrees to underwrite the expenses associated with the Joint City Bond Counsel (whether or not a Transaction is consummated), provided that the Participants each agree work exclusively with Allco, and participate with other cities contemplated in the Transaction, in the selection of no more than four acceptable bond counsel firms provided that the bond counsel firms agree to work cooperatively and in an effort to minimize redundant expenses. Allco, after consultation with the LMC, shall have the exclusive right to determine that any bond counsel is not working cooperatively and in an effort to minimize expenses and, accordingly, Allco may discontinue compensation, in whole or in part, of such bond counsel firm's future fees. Allco's financial responsibility for said legal expenses will not extend beyond payment of fees of the Joint City Bond Counsel related specifically to the Transaction.

4. Reimburse the city for the reasonable costs, with respect to the Transaction, of the city's outside city attorney, if any, whether or not a Transaction is consummated. The city will provide Allco with a billing statement on a monthly basis. Allco, upon receipt of the billing statement, will send payment to the city within thirty (30) days.
5. Assist the city in identifying the potential benefits of the Transaction.
6. Assist the city in structuring the Transaction.
7. Prepare offering materials, and market the Transaction to the investment community.
8. Solicit interest from equity investors to participate in the proposed Transaction and inform city of the status of the solicitation on a periodic basis.
9. Assist in the preparation of all Transaction documents.



10. Assist in the closing and funding of the Transaction.

Once all the cities participating in a Transaction have executed this Letter of Agreement, Allco will make a good faith effort to have the appraisal process completed within six (6) months. Upon completion of the appraisal process, Allco will immediately thereafter market the Transaction to the equity investor community. Once bids have been submitted, Allco will immediately thereafter commence with the Transaction documentation. All Transaction costs will be paid either by Allco or by the equity investor and such costs will be disclosed to both the city and the LMC.

In consideration of the services cited above, the city grants Allco the exclusive right to arrange a Transaction for the city's Assets for a period of twenty-four (24) consecutive months commencing on the date of acceptance and agreement of this letter, or until the contemplated Transaction has closed.

If one party to this Letter of Agreement fails to meet its obligations, in any material respect, the other party may choose to terminate this Letter of Agreement. It is agreed that upon any such termination, the financial obligations established under this Letter of Agreement shall continue until satisfied in accordance with this Letter of Agreement.

If this proposal is acceptable to you, please sign and return a copy of this letter to us.

If you have any questions, please do not hesitate to call.



[Signature page to the Letter of Agreement
between Allco Finance Corporation and the City of Rochester, Minnesota]

Sincerely,

ALLCO FINANCE CORPORATION

By: Scott Smith
Its President

ACCEPTED BY:

City of Rochester, Minnesota

Date _____, 2003

By: _____
Its Mayor

By: _____
Its City Administrator